

China tightens control over representative offices

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A new circular published recently by the State Administration for Industry and Commerce of the People's Republic of China ("**AIC**") sets out more stringent operational rules for representative offices of foreign companies ("**Circular**"). Current restrictions are set out below.

1. Limitation on headcount of representatives

The Circular expressly stipulates that a representative office shall generally have a maximum number of four (Chinese/non-Chinese) representatives only (including a chief representative). This headcount limitation does not apply retroactively to existing representative offices, but to those which would consider alterations to their existing number of representatives. In fact, prior to the publication of this Circular, some local Administrations for Industry and Commerce ("**local AIC**") had already implemented a similar requirement. For instance, in Shenzhen, the local AIC only used to accept a maximum of three representatives, and in order to effect their registration, the representative office had to recruit a minimum number of Chinese supporting staff for the appointment of each representative. This new requirement will surely have a direct impact on representative offices which intend to have more than four registered representatives.

2. Legalisation of application documents

When establishing or altering the name of the representative office, the following new requirements will have to be complied with:

1. The "certificate of incorporation" must be submitted to AIC must evidence the existence of the head office for over two years; and
2. The "letter of creditworthiness" of the head office issued by the bank which has established the business relationship with the head office must also be notarised and legalised.

The Circular does not expressly provide whether the above requirements shall also apply to head offices incorporated in Hong Kong, Macao or Taiwan. We consider that in practice, the relevant local authorities may probably impose the same requirements.

When renewing the certificate of incorporation of the representative office, a certificate of incorporation of the head office shall again be submitted. The Circular does not stipulate whether this certificate should also be notarised and legalised.

3. Validity period of registration

According to the *Measures Relating to the Administration of the Registration of Representative Offices of Foreign Companies* dated 15 March 1983 ("**Measures**"), the

registration certificate of the representative office is valid for one year. However, in practice, the maximum term of existence of a representative office is three years.

The Circular aims to eliminate the discrepancy between the Measures and the practice, and reemphasises that the registration certificate must be valid for one year only. Representative offices must therefore ensure that its registration certificate is renewed on a yearly basis prior to its expiry date.

4. Inspection and supervision regime

The local AIC responsible for the administration of the representative offices shall perform an on-site inspection within three months of issue of the registration certificate. Each local AIC is required to establish a credit-based classification and credit recording system to supervise the representative offices which are proven to have conducted illegal activities, such as a delay in renewing its certificate of incorporation or altering its address without registering it.

If a representative office is engaged in revenue generating business activities, the local AIC can impose sanctions by revoking the registration certificate of the representative office.

5. Collaboration between AIC and PSB

The local AIC and the public security bureau (“**PSB**”) shall improve mutual communication to exchange information on the registration and any illegal activities of the representative offices on a regular basis.

If a representative office is involved in a suspected fraud or illegal operation, the local AIC must transfer such a case to the PSB for further investigation. If the representative office is established under a false address or operates under a non-registered address, or is not established through the proper registration process, the PSB must transfer such a case to the local AIC for further investigation.

Note that the State Council published a draft version of the *Regulation on the administration of the registration of representative offices of foreign enterprises* in August 2008, and solicited public responses in 2008. However, no such regulation has been published so far. Therefore, the Circular may impact on the final contents of this regulation.

Conclusion:

New representative offices shall comply with the Circular, particularly the rules on limiting the number of their representatives. Existing representative offices with more than four representatives will also have to fully comply with this restriction as soon as there is a change of their representatives (either following resignation or termination of employment).

More generally, the Chinese government seems to want to reduce the number of representative offices or force many of them to be incorporated as proper subsidiaries (WFOE). The Circular also seems to be an attempt to discourage foreigners from trying to obtain work and residence permits in China merely through establishing a “shell”

representative office.